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Supreme Court of the United States

OCTOBER TERM, 1951.

No. 693

NAHUM BIRNBAUM, MORRIS J. LUTTERMAN and HANA D. LUTTERMAN, co-partners, doing business under the firm name and style of BIRNBAUM & CO., suing on their own behalf and on behalf of all similarly situated stockholders of NEWPORT STEEL CORPORATION, and on behalf of NEWPORT STEEL CORPORATION,

Petitioners,

—against—

NEWPORT STEEL CORPORATION, WILPORT COMPANY, C. RUSSELL FELDMANN,

Respondents,

—and—

C. F. STAMM, ET AL.,

Defendants.

BRIEF OF RESPONDENT C. RUSSELL FELDMANN IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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BRIEF OF RESPONDENT C. RUSSELL FELDMANN IN OPPOSITION TO PETITION FOR CERTIORARI.

I.

Opinions Below.

The opinion of the District Court is reported at 98 F. Supp. 506. The opinion of the Court of Appeals is reported at 193 F. 2d 461.

II.

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254 and 15 U. S. C. § 78aa (Securities Exchange Act of 1934, Section 27).

III.

Statute and Rule Involved.

Section 10(b) of the Securities Exchange Act (15 U. S. C. § 78j(b), 48 Stat. 891) provides:

> "Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule X-10B-5 of the Securities and Exchange Commission reads:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> "(1) to employ any device, scheme, or artifice to defraud,
>
> "(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of

the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

IV.

Counter-Statement of Matter Involved.

The complaint was dismissed below for failure to state a claim upon which relief can be granted. Jurisdiction was invoked solely under Section 10(b) of the Securities Exchange Act of 1934 and Rule X-10B-5, *supra*.

Neither the plaintiffs nor Newport Steel Corporation bought or sold any securities. The Courts below, holding that Section 10(b) and Rule X-10B-5 were directed against frauds upon purchasers and sellers of securities, dismissed the complaint for failure to state a claim under that Act. Jurisdiction was not otherwise claimed.

The complaint alleges that respondent Feldmann sold to respondent Wilport Company approximately 40% of the stock of Newport Steel Corporation (not listed on any securities exchange), and thereupon the old board of directors resigned and were replaced by nominees of the new stockholder. Neither the seller (Feldmann) nor the purchaser (Wilport Company) was defrauded by the other in the sale.

Petitioners state (Petition, p. 5) that Feldmann concealed from the other stockholders an offer of Follansbee Steel Corporation to merge with Newport Steel Corporation, misrepresented the nature of the negotiations in a letter to stockholders, and then rejected the offer so that he could make the above-described sale of the stock to Wilport Company. They further state that Wilport Company intended to use Newport Steel Corporation as a "captive supplier" of steel to the Wilport Company stockholders.

Petitioners state (Petition, p. 6) that the Courts below held that a fraudulent scheme was alleged. The opinions of the Court may be read in vain for such a statement. The opinion of the District Court stated merely:

> "Even if it be assumed, without deciding, that the complaint alleges facts which amount to a fraud * * *." (Record, fol. 182)

It is only by an unsupported charge of a connection between the sale of the stock by Feldmann to Wilport, and certain letters to the stockholders, that petitioners attempt to satisfy the preliminary requirement that any alleged fraud or deceit be effected by use of the mails. (Clearly, there was no use of any other means or instrumentality of interstate commerce, or of any facility of a national securities exchange.)

However, petitioners' statement (Petition, p. 6) that the sale of stock by Feldmann to Wilport Company was effected "by false and misleading statements sent through the mails to the Newport shareholders by the various defendants herein," is belied by the immediately preceding statement that such sale was effected *without* notice to the stockholders.

Petitioners' statement (Petition, p. 6) that the rejection of the Follansbee offer was effected by false and misleading statements to the stockholders, is likewise belied by the immediately preceding statement that the rejection was effected *without* notice to the stockholders.

Finally, petitioners do not claim that they took, or refrained from taking, any action as a result of respondents' conduct.

V.

Argument.

(A) No important question is involved.

The Court below held that Rule X-10B-5 was directed solely at frauds on purchasers or sellers of securities, and was not addressed to breaches of duty by corporate fiduciaries which might constitute a common law fraud upon the

corporation or its other stockholders, who were not purchasers or sellers.

Section 10(b) of the Securities Exchange Act is not self-operative, but merely permits the Securities and Exchange Commission to adopt rules thereunder. It is the violation of the Rule which constitutes the crime. No question arises here under Section 10(b); the only question is the interpretation of Rule X-10B-5.

The Securities and Exchange Commission reads its own Rule in the same way as it has been interpreted by the Courts below. It does not claim the added jurisdiction which plaintiffs would foist upon it, and did not intervene to urge a different result.

Petitioners assert that they bring to this Court the question of the construction of Section 10(b) (Petition, p. 7). This presupposes that Rule X-10B-5 makes unlawful all common law breaches of duty by corporate fiduciaries. However, as we shall show, and as the Courts below held, Rule X-10B-5 does not have the broad purpose petitioners ascribe to it. The Commission has made no rule which covers the case at bar, and the question of the scope of Section 10(b) therefore does not arise.

(B) The decision below does not conflict with a decision of another Court of Appeals.

Petitioners do not bring themselves within Rule 38, subd. 5(b), even if the decision of the Court below were in conflict with the decision in *McManus* v. *Jessup & Moore Paper Co.*, Civil No. 8015, in the District Court for the Eastern District of Pennsylvania. The *McManus* case, which was merely a denial of a motion to dismiss without opinion, was not a decision of another Court of Appeals.

A conflict between decisions of a Court of Appeals and of a District Court in another Circuit is not such a conflict as will move this Court to grant certiorari (Robertson & Kirkham, *Jurisdiction of the Supreme Court of the United States*, 1951 Ed., § 325).

Further, the *McManus* case, being without opinion, is not in conflict with the decision below; it is impossible to ascertain from the court records whether jurisdiction was found to exist under the Securities Exchange Act or under the Bankruptcy Act, under which jurisdiction was also invoked.

(C) Interpretation of Rule X-10B-5 by the Securities and Exchange Commission.

When Rule X-10B-5 was promulgated, it was accompanied by Release No. 3230 of May 21, 1942, which explained the purpose and scope of the Rule as follows:

> "The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. *The new rule* closes a loophole in the protections against fraud administered by the Commission by *prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.* The text of the Commission's action follows:" (Italics supplied.)

Subsequently, when asked for an interpretation of the Rule, the Securities and Exchange Commission in Release No. 3634 of December 22, 1944 reiterated:

> "* * * Generally speaking, this Rule embodies the broad anti-fraud provisions of Section 17(a) of the Securities Act of 1933 but specifically prohibits fraud not only in connection with the sale of securities but also in connection with the purchase of securities." *

The administrative interpretation of the rule by the Securities and Exchange Commission makes the purpose and scope of the rule clear.

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* Section 17(a) of the Securities Act of 1933 (15 U. S. C. § 77q(a), 48 Stat. 84) applies only to a fraud or deceit "*upon the purchaser*" of securities. It reads in pertinent part: ". . . It shall be unlawful for any person in the sale of any securities . . . to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

The purpose of Rule X-10B-5 is to fill a gap in the Commission's power over fraudulent transactions in securities. Section 17(a) of the 1933 Act (15 U. S. C. § 77q(a), 48 Stat. 84) prohibits fraudulent practices in the *sale* of securities where use is made of the mails or interstate commerce is involved. Rule X-15C1-2, promulgated by the Commission under Section 15(c)(1) of the 1934 Act (15 U. S. C. § 78o(c)(1), 48 Stat. 895, as amended by 49 Stat. 1377 and 52 Stat. 1075), contains similar provisions applicable to registered brokers or dealers, with respect to either purchases or sales. Neither of these provisions prohibited fraud by others than broker-dealers in the *purchase* of securities. The Commission's answer to this loophole was the promulgation of Rule X-10B-5, which is expressly applicable to purchases or sales by any person. See Note, 59 Harv. L. Rev. 769, 770 (1946).

(D) Petitioners' contentions are without merit.

We submit that Rule X-10B-5 is clearly addressed to market manipulations and frauds upon purchasers and sellers of securities, and that the Commission did not intend to supersede existing civil procedures for the prosecution of actions against corporate fiduciaries for alleged breaches of their common law duties, when the party allegedly injured was neither a purchaser or seller of securities.

The opinions of the Courts below amply prove that proposition.

VI.

The Writ Should Be Denied.

Respectfully submitted,

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